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SUBJECT: LEBANON: WORLD BANK MIDDLE EAST DIRECTOR ON PARIS  
III

SUMMARY

1. (U) World Bank Middle East Department Director Joseph Saba noted Nasrallah's October 31 ultimatum as disturbing and a challenge to the confidence that holds up Lebanon's fiscal house of cards, but views awareness of the need for essential economic reforms as recognized across the Lebanese political spectrum. Saba is still expecting a late January conference, and hopes for a core group preparatory meeting in December. GOL Paris III conference documents are nearly ready, and the World Bank's sectoral analysis of expenditures is revving up and expected to be available by the beginning of December. Based on its analysis of the economic and social impact of the conflict, Lebanon's debt dynamic is back - and its primary surplus is gone. Saba opined that, even if Lebanon undertook all the necessary, critical reforms over the next five years, its debt picture would not be sustainable (though the reforms would have a positive effect). End Summary.

THE STATE OF PLAY

2. (U) World Bank Middle East Department Director Joseph Saba began his conversation with embassy officers by noting Nasrallah's disturbing speech on 31 October, in which he gave an ultimatum that dialogue between the March 14 coalition and Hizballah and its allies progress or else Hizballah will mount street demonstrations. Any reform program will require major government consensus, Saba stated, and political divisions are not helpful. Saba has asked the GOL for a core group meeting ahead of Paris III, possibly as early as December, and says a small group with "political and economic firepower" would be more effective.

3. (U) According to Saba, the GOL paper is essentially ready, but the data is of such poor quality that at some point it is all conjecture. The GOL has had an economic reform plan and conference paper in process for some time. The program and paper are essentially sound, close to what the World Bank would like to see, but the GOL's major obstacle is building consensus and political will for reform. The Bank is finishing its economic and social impact statement, and is working on a sectoral expenditure analysis, to be published in December. The Bank is providing technical and financial assistance in support of the GOL reform program with the hope of achieving early results ahead of Paris III. Its sectoral assessment of expenditures is scheduled for GOL review later this month and publication in early December.

DEBT IS UNSUSTAINABLE

14. (U) The Bank believes that in the short term there is sufficient money for reconstruction, claiming the Council for Development and Reconstruction has \$1 billion on hand. While the physical damage can all be repaired, Saba advised that the indirect economic and public finance outlook is "depressing." The Bank's impact assessment will conclude that the debt situation will continue to worsen as businesses seek tax relief, revenues continue to fall, and expenditures related to the conflict rise. Saba noted the debt situation is only sound as long as everyone believes that the government can roll it over (no one expects it to be repaid); but should confidence in the government's ability to roll over its debt evaporate, then a debt crisis could ensue. (50 percent of total Lebanese public debt is owned by Lebanese commercial banks.) Saba emphasized that, and even if all needed reforms were taken during the next five years, these reforms still would not bring the debt down to a "sustainable" level.

#### PARIS III

15. (U) Saba declared that the World Bank is much more committed to being involved in Lebanon now than it had been during Paris II, and the Bank has a far better working relationship with the GOL. Saba expects that the Bank will be able to say in Paris that it agrees with the GOL program. The Bank would like to see fiscal and structural reforms beyond what the GOL is considering in its reform and recovery plan for the Paris III conference (scheduled for late January 2007), but Saba realizes they are politically impossible at the current time. The major difference between the GOL and World Bank relates to "burden sharing" (debt restructuring)

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and inadequate GOL consensus on the need for increased social protection. Saba believes there is a large national consensus for social programs and basic reforms, so the World Bank is helping the GOL focus on these for the conference. Saba also described a growing populist movement against Paris III - those that remember the "belt tightening" that followed Paris I and II. These people anticipate only pain from Paris III. They look back at the massive cash inflows following earlier donor conferences that had little or no impact on the social situation or public finance; they blame the GOL and corrupt politicians for wasting the money. Saba hopes that Paris III will address these "populist" issues. He pointed out that, while the GOL is spending at OECD levels in health and education, it is not getting the impact it needs to satisfy its citizens. The problem is the GOL's delivery system -- it is unable to use its resources quickly or efficiently (what Saba called the problem of "implementation"). The World Bank is providing USD 1 million of its recently announced \$70 million grant to the GOL to help it improve its ability to provide Government services in a transparent, accountable, and efficient way. The Bank believes the population needs to see its government "doing something."

16. (U) The Bank is also providing technical and financial assistance in the priority areas of power, fiscal management, and social protection ahead of Paris III. When asked about the commitment of the GOL to privatization of the electricity utility, which consumed \$1.1 billion of GOL revenues last year, Saba reported that the Energy and Water Minister, Mohamed Fneish, has asked for a "service" management contract, a first step toward corporatizing the national power utility. The World Bank is providing technical assistance and preparing the tender documents. The Bank has also created a small (USD 20-25 million) multi-donor trust fund in advance of Paris III, and will donate USD 3-5 million as a political inducement to donors to back key early reforms. Saba expects that such a fund could also have the effect of imposing a kind of conditionality on the GOL, since donors would supervise operation of the fund through periodic

meetings and a continuing relationship with the GOL.

LEBANON NEEDS "AN ADULT IN THE ROOM"

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17. (U) Asked about the prospects for reform, Saba lamented that structural reforms in the power, social, and economic sectors are acknowledged across the political spectrum as necessary, but no one wants to see another confession gain from changes. Saba commented that no other Lebanese government would have a greater level of commitment to reform; every group seems to know what changes are needed, rather, it is political reality of individuals unwilling to see their political rivals benefit from change that blocks reform. Saba described Fneish as a professional committed to his own well-articulated reform program and to the plans of his predecessors. The real obstacles to reform in the energy sector are the wide variety of politicians who refuse to work with the World Bank "on its terms" (i.e., in a transparent manner). For that reason it is important to have "an adult in the room" to fix things, because the health and the welfare of the "kids" is in danger. Saba viewed Hizballah constituents as having suffered most under previous rounds of fiscal tightening and the group most prone to oppose the current reform plan.

FELTMAN